

John Williams'
Shadow Government Statistics
Analysis Behind and Beyond Government Economic Reporting

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September Trade Deficit

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**September Trade Data Suggest
Minimal Upside Contribution to Pending GDP Revision**

U.S. Fiscal Disaster Surpasses Any Problems Seen With Major Trading Partners

Pending Special Commentaries

PLEASE NOTE: The next regular Commentary is scheduled for Tuesday, November 15th, covering October retail sales and PPI. That will be followed by Commentaries on the 16th and 17th covering, respectively, October CPI and industrial production, and October housing starts.

—Best wishes to all, John Williams

Opening Comments and Executive Summary. Wild market gyrations around the latest news out of the euro-area simply highlight extreme instability and danger present in the current global and domestic financial systems and the rapid explosion of systemic solvency issues. The continued faltering of broad U.S. economic activity is in the process of intensifying. These factors, in combination, promise continued market instabilities, and likely extraordinary financial and fiscal measures by central banks and governments. New action most likely will be forthcoming from the Federal Reserve and even from the extremely-politicized Congress and White House, if the politicians get scared enough. The general

outlook is not changed from what has been discussed in the [Hyperinflation Special Report \(2011\)](#) and in recent and the current *Hyperinflation Watch* section, but a number of issues are likely to come to a head in the next several months, not the least of which is what will come out of the Congressional Super Committee that is in the process purportedly of making minimal cuts to the federal budget deficit.

Special Commentaries—Revisiting and Reviewing the Systemic Solvency and Economic Crises.

Today's *Commentary* is relatively brief, as result of a week light in major economic releases. In contrast, next week's calendar provides for five major October economic releases in three *Commentaries*, including what are planned as two *Special Commentaries*, one on Wednesday, November 16th, that will address the current GAAP-deficit of the United States and ways it could be addressed; and one on Thursday, November 17th, addressing underlying U.S. economic reality and what would have to happen to return to economic growth. The story has not changed, but the issues and systemic limitations are worth revisiting.

Subsequent to next week's *Special Commentaries*, and following the release of the federal government's GAAP-based (using generally accepted accounting principles) financial statements for fiscal 2011 (scheduled for publication on December 15th), I plan to publish a fully revamped *Hyperinflation Report*.

September Trade Deficit. The shortfall in September U.S. trade narrowed from August's estimate, which was reduced in revision. With three months of reporting now in hand, the third-quarter trade deficit is improved slightly from what had been estimated by the Bureau of Economic Analysis for the initial third-quarter GDP reporting. Accordingly, the net export account could offer a small, positive contribution to the pending November 22nd first revision of third-quarter GDP.

Hyperinflation Watch—U.S. Issues Should Trump Euro Concerns. As will be discussed in next week's *Special Commentaries*, the 2011 GAAP-based U.S. deficit likely fell in the \$5-trillion to \$7-trillion range, a circumstance that is beyond control and appears to be uncontainable in the current political circumstance. With the economy in ongoing crisis, with no prospect of a turnaround in the foreseeable future, the implications for the federal budget deficit, U.S. Treasury funding needs and prospective banking-system stability, in the year and years ahead, are horrendous. The current, relatively happy forecasts for each of those areas are based on assumptions of solid economic growth going forward. That growth simply will not be forthcoming.

The sovereign solvency crisis in the United States easily could move to the center of global financial-market attention in the weeks ahead, depending on how the federal deficit reduction negotiations evolve. The systemic solvency crisis that continues to unfold in the U.S. is of a relative magnitude that eclipses the rolling financial crises in the euro area.

Repeated from the prior *Commentaries*, there are no happy solutions available here to remedy the crises, only tools—devil's choices—for the Fed and the U.S. government to buy a little extra time. From the Fed's standpoint, keeping the banking system afloat remains its primary concern, although needs for economic growth and contained inflation will be given as the rationale behind any overt change in policy. The ultimate cost in propping the system, however, remains inflation. The economic and systemic-solvency crises and the broad inflation and economic issues detailed in the [Hyperinflation Special Report \(2011\)](#) and in recent *Commentaries*, continue to unfold with outlooks that remain unchanged.

The root source of current global systemic instabilities largely has been the financially-dominant United States, and it is against the U.S. dollar that the global markets ultimately should turn, massively. The Fed and the U.S. Treasury likely will do whatever has to be done to prevent crises in the euro-area from triggering a systemic collapse in the United States. Accordingly, it is not from a euro-related crisis, but rather from within the U.S. financial system and financial-authority actions that an eventual U.S. systemic failure likely will be triggered, seen initially in a rapidly accelerating pace of domestic inflation—ultimately hyperinflation.

The financial markets still are roiled by deepening crises of confidence in the U.S. dollar and in the long-term outlook for U.S. financial, economic, systemic and political instability. For those living in a U.S. dollar-denominated world, regardless of any ongoing near-term extreme volatility in the U.S. dollar—in either direction—versus the stronger major currencies and gold, the stronger currencies and precious metals remain the fundamental hedges against what lies ahead.

Massive, fundamental dollar dumping and dumping of dollar-denominated assets may start at anytime, with little or no further warning. With a U.S. government unwilling to balance or even to address its uncontrollable fiscal condition; with the federal government and Federal Reserve standing ready to prevent a systemic collapse, so long as it is possible to print, spend, loan or guarantee whatever money is needed; with the U.S. dollar at increasing risk of losing its global reserve currency status; much higher inflation lies ahead, in a circumstance that rapidly could evolve into hyperinflation.

REPORTING DETAIL

TRADE BALANCE (September 2011)

September Trade Data Suggest Small Upside Contribution to GDP Revision. The September trade deficit narrowed slightly versus the August trade shortfall, which also narrowed in revision versus its initial reporting. Adjusted for inflation, the resulting annualized third-quarter deficit showed a minimal improvement against what had been suggested for the third-quarter based on July and August reporting. Where the Bureau of Economic Analysis (BEA) initially estimated the third-quarter GDP net-exports account using just two months of data, today's reporting suggested a small positive contribution to the revision of third-quarter GDP due on November 22nd. The small improvement in the revised trade numbers is on top of an already-positive contribution made to the existing GDP estimate from the previously estimated third-quarter trade deficit. Going forward, though, underlying fundamentals still suggest an ongoing deterioration in the U.S. trade balance.

Nominal (Not-Adjusted-for-Inflation) Trade Deficit. The BEA and the Census Bureau reported today (November 10th) that the nominal, seasonally-adjusted monthly trade deficit in goods and services for September 2011 narrowed to \$43.1 billion from a revised \$44.9 billion (previously \$45.6 billion) in

August. The September 2011 deficit also was slightly smaller than the \$44.0 billion reported for September 2010.

Heavy distortions appear to be playing out in seasonal adjustments, much as has been seen in other economic releases, such as retail sales, where the headline number reflects month-to-month change. As has been discussed frequently (see the [Hyperinflation Special Report \(2011\)](#) for example), the extraordinary length and depth of the business downturn have disrupted regular seasonality patterns. Accordingly, the markets should not be relying heavily on the accuracy of monthly headline data, at present.

Against the revised August data, the reported seasonally-adjusted September trade balance showed gains in both exports and imports, with the pace of increase in exports rising faster than for imports. That pattern was true for the reporting of the trade flow in goods, although the adjusted services sector showed a declining surplus, with lower exports and higher imports. Services data are inadequate for the BEA and Census to report that heavily gimmicked series with separate seasonally-adjusted and unadjusted estimates.

For the goods sector, though, the not-seasonally-adjusted numbers also showed that exports rose, but the import numbers fell, reflecting both a decline in oil prices and in physical oil import volume. Specifically, for the month of September 2011, the not-seasonally-adjusted average price of imported oil eased to \$101.02 per barrel, down from \$102.62 in August, but up from \$72.33 in September 2010. In terms of not-seasonally-adjusted physical oil imports, September 2011 volume averaged 9.338 million barrels per day, down from 9.757 million in August 2011, and down from 9.754 million in September 2010. After seasonal adjustment, oil imports gained slightly.

Real (Inflation-Adjusted) Trade Deficit. Adjusted for seasonal factors and net of oil price swings and other inflation (2005 chain-weighted dollars as used in reporting real GDP), the reported September merchandise trade deficit came in at \$45.4 billion, narrowed from a revised \$46.3 (previously \$47.0) billion in August.

With full initial reporting now in place for third-quarter 2011, the annualized trade deficit for third-quarter 2011 is \$550.1 billion (previously estimated at \$557.6 billion based on reporting of the first two months of the quarter), and against a revised annualized real second-quarter 2011 merchandise deficit of \$566.1 billion (previously \$567.4 billion). The new data could contribute a small upside revision to the second estimate of third-quarter GDP, due for publication on November 22nd.

Week Ahead. Although still not widely recognized, there is both an intensifying double-dip recession and an escalating inflation problem. Until such time as financial-market expectations catch up with underlying reality, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the month and months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

Retail Sales (October 2011). October retail sales are scheduled for release on Tuesday, November 15th, with inflation-adjusted details available on November 16th, in conjunction with November's consumer inflation data. Given the underlying broad weakness in consumer financial conditions and confidence, and the unstable nature of concurrent seasonal-factor adjustments for this series, a downside surprise is a

fair bet against what likely will be a relatively soft consensus estimate. Increasingly, reported retail sales gains will reflect nothing more than rising prices, with declining sales volume as measured by physical consumption of goods and services.

Producer Price Index—PPI (October 2011). The October PPI is scheduled for release on Tuesday, November 15th. Seasonal adjustments should keep the impact of October oil prices in positive territory (monthly average for Brent down 2.7%, West Texas Intermediate up 0.9%, based on St. Louis Fed data). With the continued spread of the impact of higher oil costs throughout the U.S. economy, there is some risk of an upside surprise to a likely flat consensus estimate of the otherwise highly volatile series.

Consumer Price Index—CPI (October 2011). The October CPI is scheduled for release on Wednesday, November 16th. Whatever increase is seen in month-to-month October consumer inflation likely will be from areas other than energy. Gasoline prices still get something of a seasonal-adjustment boost in October, but not enough to turn the unadjusted 4.4% decline in monthly gasoline prices in October (per Department of Energy) to the plus side in the CPI. Nonetheless, spreading systemic inflation should add upside risk to this month's reporting versus what likely will be a flat-to-minus consensus outlook.

Year-to-year total CPI-U inflation would increase or decrease in October's reporting, dependent on the seasonally-adjusted monthly change, versus the 0.25% gain in the adjusted monthly level reported for October 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual unadjusted inflation rate for October 2011, the difference in October's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from September 2011's reported annual inflation rate of 3.87%. For example, if the monthly October CPI-U were unchanged, the annual inflation rate would ease back to roughly 3.6%.

Industrial Production (October 2011). The release of October industrial production is scheduled for Wednesday, November 16th, and should be flat-to-minus, net of revisions. That likely will be weaker than consensus.

Residential Construction (October 2011). The release of October housing starts on Thursday, November 17th, should show a continued downside bottom-bouncing trend. Any upside surprise likely would not be statistically meaningful.
